

National Economy

Year-End 2011



TRANSWESTERN

The Performance Advantage in Real Estate



The National Economy

Year-End 2011

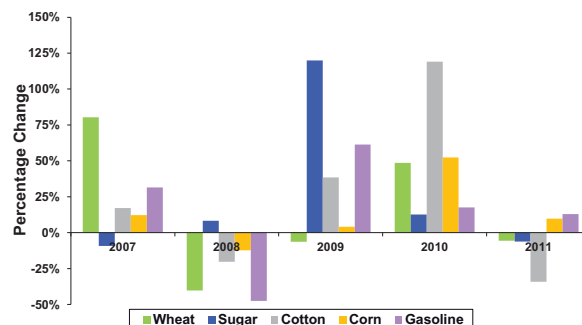
Uncertainty Hampers Economic Growth

A sense of uncertainty has increased of late, created a pull-back in consumer spending, business investment, decision making in general, tenant leasing, and commitments of all types – slowing national economic growth. An increasing sense of uncertainty has emanated from problems abroad such as the European debt crisis and the direction the Arab Spring seems to be taking. On the domestic front, there is uncertainty due to a dysfunctional Federal government, moving from deadlock to crisis.

Much of the global economic focus during the past few months has been on the European debt crisis and its potential effects on the rest of the world. Several proposals to resolve this crisis have been floated, including the most recent on November 30 that involved a coordinated strategy among central banks to ease the European credit crunch. Still, while this latest proposal increases liquidity, it does not address the main problem of excessive sovereign debt. The lack of political resolve to find a coordinated solution to the debt crisis has magnified the problem, and even caused some economists to suggest that euro zone countries may abandon the common currency. If this intransigence persists, what might the effects be on the U.S. economy, and in turn, our commercial real estate markets?

One possibility of a continuing European debt crisis is that consumer demand in Europe remains stagnant, pushing the E.U. nations into recession. This would have repercussions in China, which counts Europe as its largest export market. If consumer demand in Europe and China both slow, global prices for commodities are likely to decline, a trend that has already begun. For U.S. consumers, who over the past few years saw an increase in commodity prices far exceeding wage increases, this is a positive development. In particular, the rising price of gasoline diverted Americans' discretionary income away from consumer goods and toward a basic need. Downward pressure on gasoline prices and other staples could help Americans' real household income gain traction, further boosting Americans' consumer confidence and willingness to spend, which will aid U.S. economic growth.

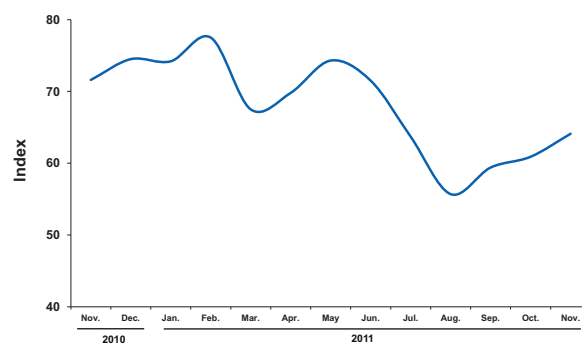
**U.S. Commodity Prices:
Mixed in 2011 After Big Increases in 2010**



Source: indexmundi.com, Department of Energy, Delta Associates; December 2011.

This is not the preferred approach to a U.S. economic recovery. Steady, global economic growth is the less volatile and more desirable path. But not all developed economies trend the same way at the same time. It is possible a recession in Europe and a slowdown in China could make goods more affordable to American consumers at a time when they still need all the help they can get. With consumer spending responsible for 70% of U.S. GDP, growth in consumer spending is essential for a more robust domestic recovery.

**U.S. Consumer Sentiment:
Volatile, But Rising**



Source: University of Michigan, Delta Associates; December 2011.

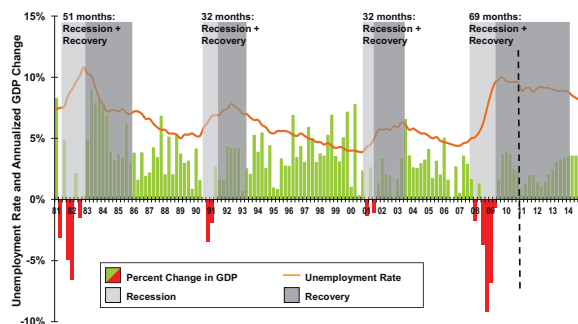
Regarding U.S. commercial real estate, the traditional notion of real estate as an inflation hedge suggests that a low-inflation environment created by economic weakness in Europe and China might pull capital away from real estate. However, tremendous volatility in the stock market has meant that capital continues to find its way to real estate – even in a protracted recovery, real estate may be the most desirable asset class on a risk-adjusted basis. The stable nature of real estate – on a relative basis – makes it a worthwhile investment during these unpredictable times. In addition, the modest pipeline of new product in most commercial asset classes means that as domestic demand improves tighter markets will follow.

Overall, this is a challenging time to be in the commercial real estate business – or virtually *any* business. But for all of the struggles we have endured domestically, the U.S. is among the best-positioned of the major world economies for the period ahead. While modest growth feels weak compared to robust expansion periods (or even recoveries) of the recent past, it is much better than a double-dip recession. We believe that even as troubles persist in other parts of the world, the U.S. economy can sustain its nascent recovery.

For the U.S. commercial real estate markets, even modest economic growth should allow for rising asset values, improving cash flow, and a slowly rising demand for space. We think the euro zone debt crisis will have limited impact on U.S. commercial real estate.

Domestically, we expect gradually improving economic conditions during 2012. Conditions should be sluggish during the 1st half, with greater improvement during the 2nd half of the year. As concern about current economic conditions ebbs, we believe corporations will utilize stockpiled resources for hiring. Once hiring picks up pace, consumers will regain confidence and begin to spend more.

U.S. Economic Trends and Forecast 1981 – 2014



Source: BLS, BEA, Center for Regional Analysis, FOMC, CBO, Delta Associates; December 2011.

We believe that even as troubles persist in other parts of the world, the U.S. economy can sustain its nascent recovery.

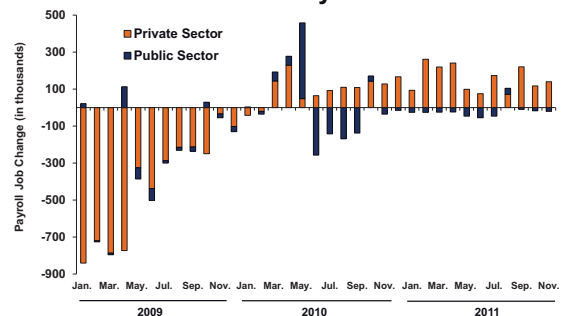
Now, for a look at the components that make up our economy:

Payroll Jobs

The national economy added 120,000 new jobs during the month of November 2011. The private sector added 140,000 new jobs during November. Private sector growth was offset by the public sector shedding 20,000 jobs.

Companies remain cautious in hiring. The debate in Congress regarding the Federal budget, European debt crisis, and downgrade in AAA status contributed to businesses taking a wait-and-see approach.

U.S. Payroll Job Change Monthly



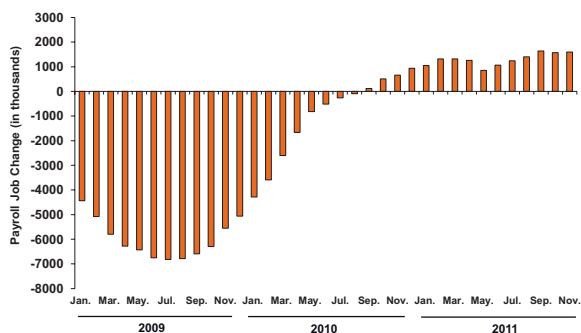
Source: Bureau of Labor Statistics, Delta Associates; December 2011.

We expect more jobs to be trimmed from the public sector during 2012, as governments cut their workforces to make up for budget shortfalls. However, these losses will be more than offset by continued growth in the private sector. Although we expect the private sector to grow during 2012, the pace of growth will be muted. We do not expect the pace to improve significantly until after the 2012 election.

The \$447 billion jobs bill proposed by President Obama has gained little traction. Although legislation to put unemployed veterans has been signed into law, other parts of the bill remained stalled. It is unlikely the full bill will be passed, given the Republican dominance of the House.

Month-to-month job growth has been uneven – reflecting continued uneasiness in permanent hiring, as confidence in the economy remains lackluster. The reduced confidence has translated to the year-over-year job growth, as 1.6 million new jobs have been added to the economy during the 12 months ending November 2011. The growth has been lackluster during the past several months. We expect sluggish job growth in the near-term, with greater gains during late 2012.

U.S. Payroll Job Change Year-Over-Year



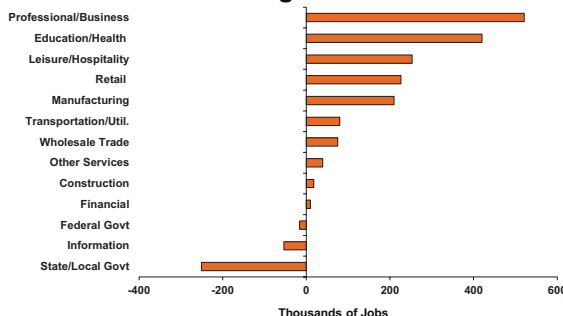
Source: Bureau of Labor Statistics, Delta Associates; December 2011.

During the 12 months ending November 2011, nine sectors added jobs. The top three sectors in job gains were Professional/Business Services, Education/Health, and Leisure/Hospitality – adding a total of 1.2 million new jobs.

We expect sluggish job growth in the near-term, with greater gains during late 2012.

The State and Local Government shed the most workers over the past year, cutting 251,000 positions. The Government sector (both Federal and state/local) is reducing its workforce as budget austerity measures are put in place.

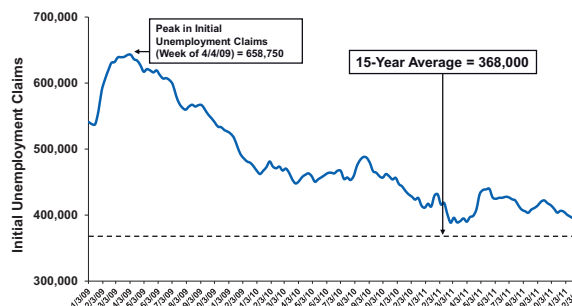
U.S. Payroll Job Change Selected Sectors 12 Months Ending November 2011



Source: Bureau of Labor Statistics, Delta Associates; December 2011.

Initial unemployment claims have been declining unevenly since the peak in early April 2009 at 659,000. Claims are 393,000 as of early December 2011 – above the 15-year average of 368,000. We expect claims to remain at the current level through most of 2012, with a steady downward trend not occurring until late 2012.

U.S. Initial Unemployment Claims Four-Week Moving Average

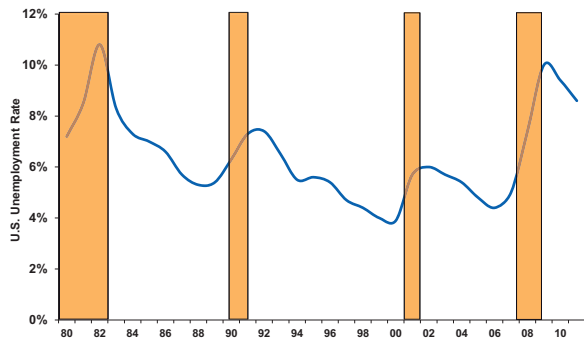


Source: Department of Labor, Delta Associates; December 2011.

Note: Data is seasonally adjusted.

The **unemployment rate** has ticked down to 8.6% as of November 2011 from 9.8% one year ago. Although this decline provides optimism in the economy, it should be observed with caution, as the rate decline was due in part to people giving up looking for work and dropping out of the workforce. The number of unemployed remains stubbornly high at 13.3 million.

U.S. Unemployment Rate



Source: Bureau of Labor Statistics, Delta Associates; December 2011. Note: Through August 2011; seasonally adjusted; shaded bars represent recessions.

We anticipate the unemployment rate will not edge down materially in the short run, as formerly discouraged job applicants start the application process again. This could push the rate higher in 2012. Unemployment will be slow to descend, remaining around 9.0% during 2012.

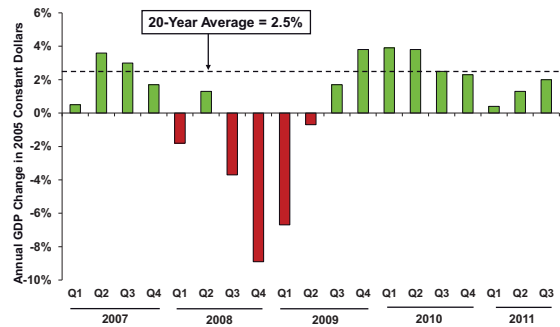
Unemployment will be slow to descend, remaining around 9.0% during 2012.

Gross Domestic Product (GDP) and Consumption

GDP increased 2.0% (annualized rate) during the 3rd quarter of 2011, after rising 1.3% (revised) during the 2nd quarter. This increase is below the 20-year annual average of 2.5%. The slow rise during the 3rd quarter appears consistent with the mood of the nation – uncertainty.

We anticipate modest GDP growth during the 4th quarter of 2011 – in the 2.0% to 2.5% range. GDP growth should ebb slightly during the 1st and 2nd quarters of 2012 in the 1.5% to 2.0% range, as uncertainty continues.

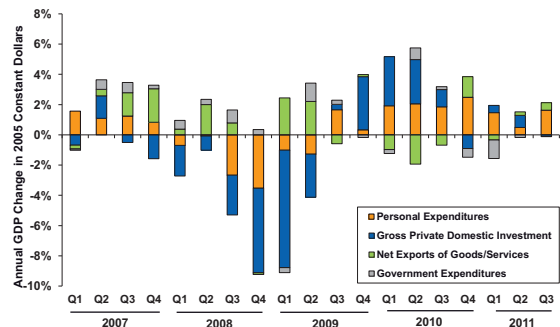
U.S. GDP Percent Change 2007 – 2011



Source: Bureau of Economic Analysis, Delta Associates; December 2011. Note: Annualized.

Expansion was driven by personal expenditures during the 3rd quarter, which contributed 1.6% to the GDP growth. Gross private domestic investment and government expenditures were a drag on GDP, contributing negative 0.1% and negative 0.02%.

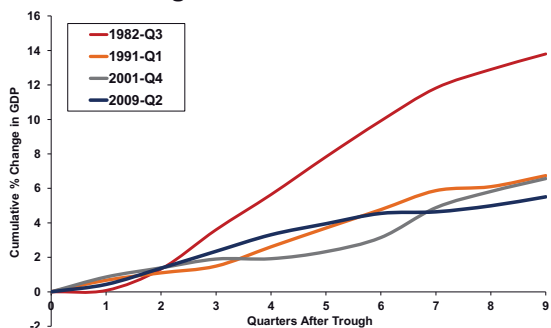
Contributions to U.S. GDP Percent Change 2007 – 2011



Source: Bureau of Economic Analysis, Delta Associates; December 2011. Note: Annualized.

Uncertainty has led to reduced job gains and muted consumer spending. Despite our anxiety over this slow recovery, GDP growth rates of this recovery cycle continue to track similarly to the prior two recession/recovery cycles of 1991 and 2001.

Recovery Patterns of GDP Following the Past Four Recessions



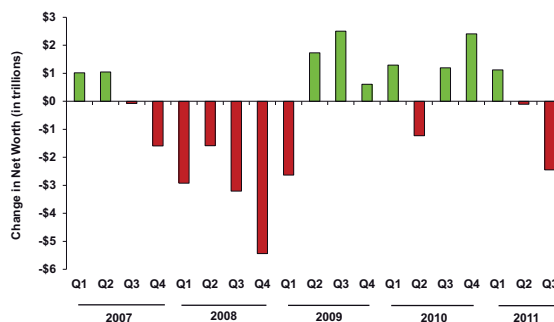
Source: BEA, GMU Center for Regional Analysis, Delta Associates; December 2011.

Despite our anxiety over this slow recovery, GDP growth rates of this recovery cycle continue to track similarly to the prior two recession/recovery cycles of 1991 and 2001.

Although **consumer spending** is helping to boost GDP, spending has been restrained due to low consumer confidence, thanks to high uncertainty. We expect this trend to continue in the near-term, as household net worth took a notable hit during the 3rd quarter of 2011.

Net worth declined by \$2.5 trillion during the 3rd quarter of 2011. Net worth struggled during the 3rd quarter due to slumping home prices and a decline in the stock market. This decline in net worth is a hit to consumers, after households lost over \$17 trillion in **personal wealth** from the 4th quarter of 2007 to the 1st quarter of 2009. Although households have regained some of the assets lost, gains have been uneven and it will take several years to recoup the total amount.

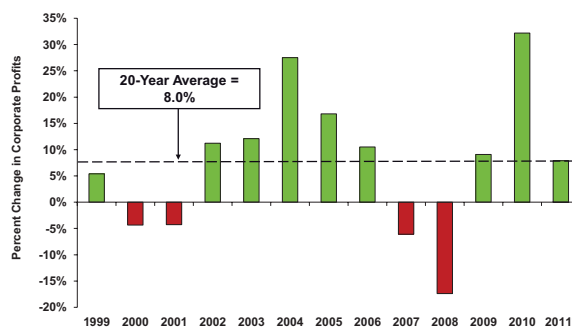
U.S. Household Net Worth 2007 – 2011



Source: Federal Reserve, Delta Associates; December 2011.

Also due to uncertainty, U.S. companies are sitting on piles of cash, waiting for clear signals that the economy is on a consistent recovery path. Corporate profits rose 7.9% during the 12 months ending September 2011, after surging 32% during 2010. This compares to the 20-year annual average of 8.0%. Companies have the resources to hire, but remain wary about future demand for their products and services.

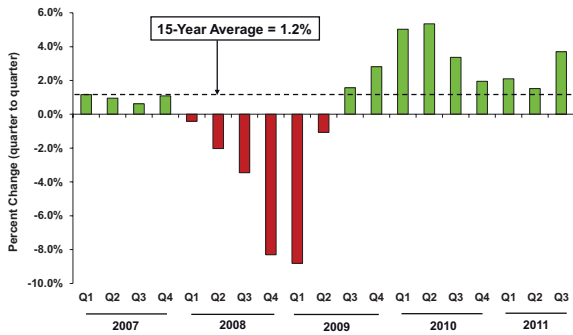
U.S. Corporate Profits



Source: Bureau of Economic Analysis, Delta Associates; December 2011. *12 months ending September 2011.

Notably, businesses are increasing investment in equipment and software. During the 3rd quarter of 2011, investment increased 3.7%, well above the 15-year quarterly average of 1.2%.

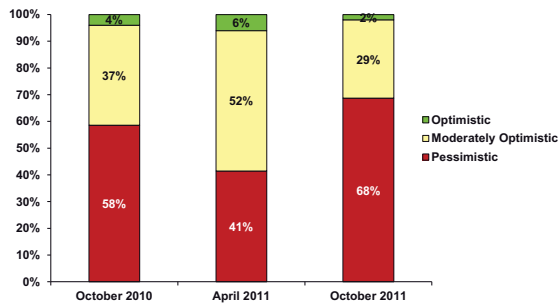
Investment in Equipment and Software Constant Dollars



Source: Bureau of Economic Analysis, Delta Associates; December 2011.

Despite gains in profit and rising investment in equipment and software, small and mid-sized businesses are less optimistic about the national economy compared to one year ago. Of those surveyed by PNC Bank, 68% are pessimistic about current economic conditions, up from 58% one year ago. This pessimism has fueled cash hoarding as well as caution in hiring, as only 20% plan to hire during the next six months, while 14% plan to reduce staff, according to the survey.

Business Owners' Outlook on National Economy



Source: PNC Bank, Delta Associates; December 2011.

Note: totals might not add to 100% due to rounding.

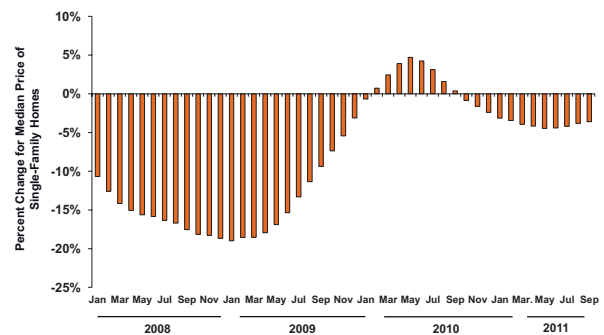
Housing Market

Home prices in the 20 major metro areas declined 3.6% during the 12 months ending September 2011, the most recent data available, according to S&P/Case-Shiller. The housing market has struggled with recovery, as unemployment remains high, foreclosures dampen gains, and lending standards remain tightened.

With home prices falling, the number of mortgages underwater (where the homeowner owes more on the mortgage than the home is worth) remains elevated. According to CoreLogic, 22% of all mortgaged homes were underwater at the end of the 3rd quarter of 2011. Nevada had the highest percentage of underwater mortgages at 58%.

We expect home prices to decline further through mid-year 2012, as the inventory remains elevated and confidence is lackluster. Thereafter, prices should start to stabilize.

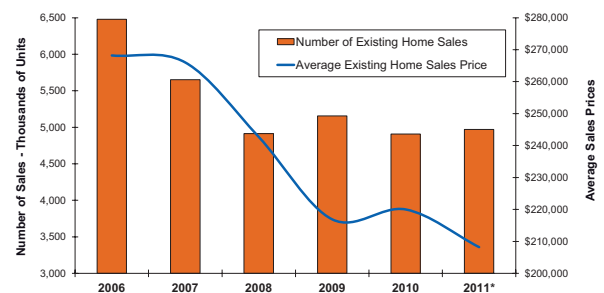
Annual Change in Existing Home Sale Prices



Source: S&P/Case-Shiller, Delta Associates; December 2011.

The number of sales increased to 5.0 million (annualized) during October 2011, compared to 4.9 million during 2010. However, the number of sales is below the level achieved at the peak of the market. The sales price averaged \$208,200 during October 2011, down 4.6% from one year ago, according to the National Association of Realtors.

U.S. Existing Home Sales vs. Sales Price



Source: National Association of Realtors, Delta Associates; December 2011. *Annualized sales rate at October 2011.

We expect home prices to decline further through mid-year 2012, as the inventory remains elevated and confidence is lackluster. Thereafter, prices should start to stabilize.

Between little pressure in the economy and the Fed's commitment, we see a low probability of a meaningful increase in long term interest rates in the next 18 months.

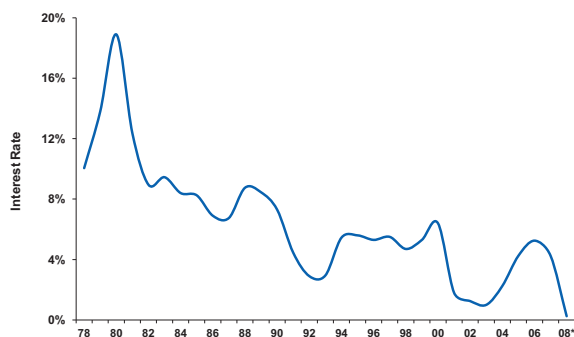
Federal Intervention and Inflation

The Federal government continues to implement programs to sustain the national economy, vowing to do what it takes to keep the economy on track.

The Federal Reserve has kept the Federal Funds Rate at its current low level, as some business sectors continue to shed jobs. Given the economy continues to grow at a slow pace, the Fed plans to keep short-term rates at its current range of 0% to 0.25% through mid-2013.

Regarding inflation, prices increased 3.5% during the 12 months ending October 2011. After surging during the spring, prices are starting to moderate. Gas and food prices are showing declines. Elevated unemployment, coupled with limited income growth, has helped keep prices in check, as consumers are less willing to pay higher prices right now. Slower inflation could help boost consumer spending. The Federal Reserve expects consumer prices will remain in check in the near term, with inflation estimated at 3.0% for 2011 and projected at 1.8% for 2012. We agree. As long as appropriate monetary measures are in place, inflation should remain controlled through 2012.

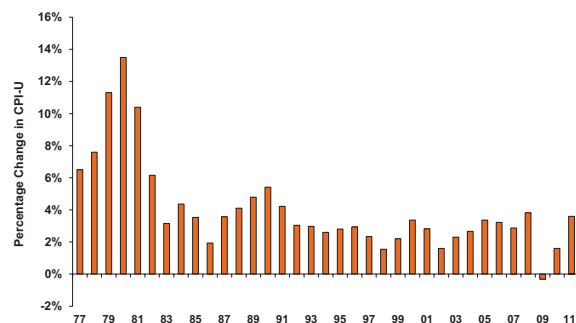
Federal Funds Rate



Source: Federal Reserve Board, Delta Associates; December 2011.

*Unchanged since December 16, 2008.

U.S. Inflation



Source: Bureau of Labor Statistics, Delta Associates; December 2011. *12-month percentage change through October 2011. Note: data is seasonally adjusted.

To affect long term rates, the Fed had introduced Quantitative Easing (or QE). This program of buying debt has helped to keep long term interest rates low. In fact at this writing a 30-year fixed rate home mortgage is below 4.0% – near an all-time low. This program seems to be over for the time being. Although, Ben Bernanke has stated that he would consider re-instituting it if needed to keep long rates down.

Between little pressure in the economy and the Fed's commitment, we see a low probability of a meaningful increase in long term interest rates in the next 18 months.

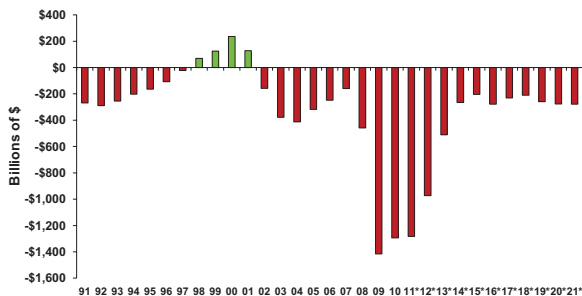
Federal Budget and Debt

The Congressional Budget Office (CBO) anticipates the U.S. budget deficit for 2011 will total \$1.3 trillion, when the numbers are finalized. The U.S. budget deficit was \$1.3 trillion in 2010, down from \$1.4 trillion in 2009. Gaining Federal budget balance has generated concern by both political parties. A split Congress and the election of many new representatives in 2010 who campaigned on the promise to cut spending have sparked heated debate on how to reduce the deficit. This debate peaked in late July as the world watched a dysfunctional government finally reach a deal on deficit-reduction and the debt ceiling, which was passed and signed into law on August 2.

The Federal Reserve expects consumer prices will remain in check in the near term, with inflation estimated at 3.0% in 2011 and projected at 1.8% for 2012. We agree.

The battle in Congress continues with both parties stubborn, fueled further by the politics of the upcoming 2012 election.

Federal Budget Deficit



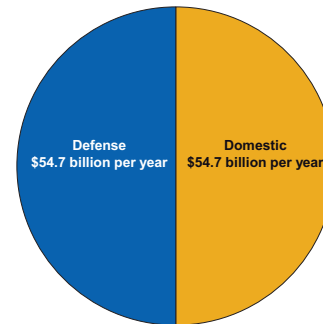
Source: OMB, CBO, Delta Associates; December 2011.

* Projected by CBO as of August 2011.

Given the supercommittee's failure to reach an agreement by November 23, automatic across-the-board cuts, totaling \$1.2 trillion over ten years, are slated to go into effect at the start of 2013.

Half the cuts will come from the Defense budget and half from the Domestic budget. Defense cuts will focus on ship building, large procurement programs, and contractors. War financing is not on the chopping block. Domestic cuts will focus on border patrol, IRS, TSA, and a handful of other Federal agencies.

Federal Budget Spending Cuts 2013 – 2022



Source: Washington Post, Delta Associates; December 2011.

It is important to note, although the automatic spending cuts are set to take effect, they might not be implemented. Congress and President Obama could agree on legislation to curtail these automatic spending cuts. The proposed plan could change as the need for programs/services changes through 2012.

Economic Outlook

We believe the national economy will experience slowly improving conditions during 2012. We expect the recovery period to last into late 2013/early 2014, at which point economic growth is likely to accelerate.

We believe the economic outlook is as follows:

- GDP: 1.6% growth during 2011, once the numbers are finalized. 2.0% to 2.5% in 2012.
- Payroll jobs: 1.4 million added in 2011 (based on December to December calculation), once the numbers are finalized. 1.5 to 1.8 million added during 2012.
- Unemployment: hovering around 9.0% during 2012.
- Federal funds rate: 0% to 0.25% through mid-year 2013.
- Long term interest rates: steady.
- Inflation: 3.0% during 2011, once numbers are finalized, declining to 1.8% during 2012.

National Payroll Job Growth Summary

The U.S. economy gained 1.6 million payroll jobs over the 12 months ending November 2011. This represents a rise of 1.2%.

U.S. Payroll Job Growth		
Year	Job Change	%Change
2011*	1,600,000	1.2%
2010	-967,000	-0.7%
2009	-5,989,000	-4.4%
2008	-809,000	-0.6%
2007	1,496,000	1.1%
2006	2,397,000	1.8%
2005	2,275,000	1.7%
2004	1,423,000	1.1%
2003	-344,000	-0.3%
2002	-1,489,000	-1.1%
2001	36,000	0.0%

*Change for 12 months ending in November 2011; others are comparisons of annual averages. Note that BLS has rebenchmarking figures since their initial publication; the figures presented above are the most recent estimates.

12-MONTH PAYROLL EMPLOYMENT CHANGE THROUGH OCTOBER 2011					
METRO AREA	JOB CHANGE		METRO AREA	JOB CHANGE	
	#	%		#	%
Houston	79,500	3.1%	Chicago	16,200	0.4%
LA Basin			Denver-Boulder	15,500	1.1%
Orange County (Santa Ana/Anaheim/Irvine)	20,400	1.5%	Oklahoma City	15,300	2.7%
Los Angeles/Long Beach/Glendale	19,000	0.5%	Baltimore	14,100	1.1%
Riverside/San Bernardino/Ontario	15,200	1.4%	Austin	13,300	1.7%
Subtotal LA Basin	54,600	0.9%	Portland (OR)	11,500	1.2%
Dallas/Ft. Worth	48,800	1.7%	Las Vegas	10,700	1.3%
Boston (Metropolitan NECTA)	47,000	1.9%	New Orleans	10,600	2.0%
San Francisco Bay Area			Salt Lake City	9,800	1.6%
San Jose/Sunnyvale/Santa Clara	27,300	3.2%	Orlando	8,600	0.9%
San Francisco/San Mateo/Redwood City	16,700	1.8%	Memphis	8,300	1.4%
Oakland/Fremont/Hayward	1,000	0.1%	San Antonio	8,100	1.0%
Subtotal Bay Area	45,000	1.6%	St. Louis	8,000	0.6%
Seattle	37,700	2.3%	Nashville	7,700	1.0%
South Florida			Raleigh-Durham	7,200	0.9%
Miami/Miami Beach/Kendall	18,900	1.9%	Washington, DC	5,900	0.2%
West Palm Beach/Boca Raton	6,500	1.3%	Charlotte	5,700	0.7%
Fort Lauderdale	5,800	0.8%	New York	4,200	0.1%
Subtotal South Florida	31,200	1.4%	Jacksonville	2,800	0.5%
Phoenix	29,900	1.8%	Kansas City	(500)	-0.1%
Tampa-St. Pete	24,100	2.2%	Sacramento	(1,300)	-0.2%
San Diego	24,000	2.0%	Columbus (OH)	(2,700)	-0.3%
Pittsburgh	21,800	1.9%	Cleveland	(3,200)	-0.3%
Minneapolis-St. Paul	21,000	1.2%	Philadelphia	(3,300)	-0.1%
Detroit (Detroit/Warren/Livonia)	17,600	1.0%	Indianapolis	(5,300)	-0.6%
Cincinnati	16,500	1.7%	Atlanta	(22,100)	-1.0%

Source: Bureau of Labor Statistics, Delta Associates; December 2011.